

1 **REBUTTAL TESTIMONY OF**
2 **THOMAS R. OSBORNE**
3 **ON BEHALF OF**
4 **SOUTH CAROLINA ELECTRIC AND GAS COMPANY**
5 **DOCKET NO. 2002-223-E**

6
7 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

8 A. My name is Thomas R. Osborne. I am a Managing Director in the Global
9 Energy and Power Group within UBS Warburg LLC's Investment Banking
10 Department. My business address is UBS Warburg LLC, 299 Park Avenue, New
11 York, NY 10171.

12
13 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS**
14 **PROCEEDING?**

15 A. Yes.

16
17 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

18 A. The purpose of my rebuttal testimony is to respond to assertions made by
19 Mr. Gorman about the comparability of the Osborne Peer Group, to affirm that
20 this peer group is an appropriate proxy for evaluating SCE&G's cost of equity
21 capital, and to state the reasons why the peer groups proposed by Mr. Gorman and
22 Mr. Parcell are not reasonable proxies for SCE&G.

1 **Q. PLEASE SUMMARIZE THE CONCLUSIONS OF YOUR ANALYSIS OF**
2 **THE DIRECT TESTIMONY OF MR. GORMAN AND MR. PARCELL.**

3 **A.** My conclusions are as follows:

4 1. Mr. Gorman states that DPL Inc. and Great Plains Energy should be
5 excluded because they “...do not meet [Osborne’s] own risk
6 selection criteria” (Gorman Page 16 at Line 14-15). Mr. Gorman
7 goes on to state that the “...business position ranking [of DPL and
8 Great Plains Energy] is out of line with SCE&G’s business position
9 of 4, and is also out of line with industry averages for utility
10 companies” (Gorman Page 17 at Line 13-15). Mr. Gorman further
11 states that the “...ratio of equity book value to total book capital ...
12 is out of line with other companies in the group” (Gorman Page 17 at
13 Line 20-21). Mr. Gorman then concludes that DPL’s ownership of
14 an investment portfolio “fails Mr. Osborne’s requirement that the
15 company be engaged primarily in regulated utility operations”
16 (Gorman Page 18 at Line 10-11) and he further cites a recent write-
17 down. I believe that a closer analysis of DPL Inc. and Great Plains
18 Energy demonstrates that they are in fact comparable companies,
19 because their financial leverage and S&P business position rankings,
20 while relevant, must be considered in the context of other mitigating
21 factors. Further, DPL’s investment portfolio does not violate the

1 principal that the company be engaged primarily in regulated utility
2 operations because it consumes a negligible amount of internal
3 operational resources and represents a source of funds for future
4 investment in the company's core energy business. As I previously
5 stated in my direct testimony, "[T]here are very few publicly traded
6 companies that have the same business model and business profile as
7 SCE&G" (Osborne Page 10 at Line 15-16) and as such I selected a
8 group of companies based on its overall comparability and exposure
9 to business and financial risks similar to those of SCE&G.

10 2. Mr. Gorman and Mr. Parcell offer their own peer groups, which
11 contain companies that I do not believe should be included as peer
12 companies for reasons which I will detail. As such, their peer
13 groups do not represent reasonable proxies for SCE&G and should
14 not be used to estimate its cost of equity capital.
15

16 **Q. WHY DOES MR. GORMAN BELIEVE THAT DPL INC. AND GREAT**
17 **PLAINS ENERGY SHOULD BE EXCLUDED FROM THE GROUP OF**
18 **PEER COMPANIES?**

19 A. Mr. Gorman's reasoning for not including DPL Inc. and Great Plains
20 Energy in the peer group he provides in Table 3 on page 21 of his direct testimony
21 is twofold. First, Mr. Gorman states that a S&P business position ranking of "6"

1 for DPL Inc. and Great Plains Energy is "...out of line with SCE&G's business
2 position ranking of 4, and is also out of line with industry averages for utility
3 companies" (Gorman Page 17 at Line 13-15). Secondly, Mr. Gorman states that
4 "DPL and Great Plains Energy's ratio of equity book value to total book capital ...
5 is out of line with the other companies in the group" (Gorman Page 17 at Line 19-
6 20). In the case of DPL, Mr. Gorman goes on to state that, an additional reason to
7 exclude DPL is that its ownership of a \$1 billion investment portfolio "...fails Mr.
8 Osborne's requirement that the company be engaged primarily in regulated utility
9 operations" (Gorman Page 18 at Line 10-11) and he notes that DPL recognized a
10 write-down in the second quarter of 2002.

11
12 **Q. ARE FINANCIAL LEVERAGE AND S&P BUSINESS POSITION**
13 **RELEVANT FACTORS TO CONSIDER IN DEVELOPING PEER**
14 **GROUPS?**

15 A. Unequivocally, financial leverage and S&P business position rankings are
16 among the relevant factors to consider when developing a group of comparable
17 companies. In fact, as stated in my direct testimony, when developing my peer
18 group I relied, in part, on these factors as metrics for assessing the comparability
19 of companies that faced business and financial risks similar to those of SCE&G.
20 However, financial leverage and business position ranking are not the only factors
21 that should be considered when evaluating the comparability of companies and

1 developing a peer group. The factors that I relied upon, in addition to financial
2 leverage and S&P business position ranking, include relative size, interest
3 coverage ratios, credit ratings, the regulatory environment in which a company
4 operates, and asset concentration, among others. In the case of DPL Inc. and
5 Great Plains Energy, I believe that there are important quantitative and qualitative
6 factors that mitigate the risks associated with higher financial leverage and a lower
7 S&P business position ranking.

8
9 **Q. WHAT ARE THE FACTORS THAT MITIGATE THOSE RISKS?**

10 A. In terms of quantitative factors, I have considered the companies' latest
11 twelve months interest coverage ratios, which I believe mitigate their leverage
12 statistics and business position rankings. For DPL and Great Plains, the coverage
13 ratios are a strong 4.7 times and 4.5 times, respectively. While these metrics are
14 lower than SCE&G's at 5.5 times, they are still within a reasonable range of
15 comparability and are, in fact, higher than the average for my peer group as a
16 whole at 4.3 times.

17 There are also numerous qualitative factors that I believe offset the risk
18 implied by these two companies' financial leverage and business position ranking.
19 In the case of DPL, such factors include the company's conservatively managed
20 utility operations, its diverse service area economy, its relatively low generation
21 costs, its declining capital expenditures and environmental compliance costs, and

1 its supportive regulatory environment. In the case of Great Plains, such factors
2 include the company's economically sound service area, extremely low fuel costs,
3 tight cost controls, excellent nuclear operations, manageable environmental risks
4 and capital program, adequate liquidity position and generally stable regulatory
5 environment.

6
7 **Q. WHAT ADDITIONAL EVIDENCE CAN YOU PROVIDE THAT THESE**
8 **FACTORS SERVE TO MITIGATE THE RISKS ASSOCIATED WITH**
9 **THE FINANCIAL LEVERAGE OF DPL INC. AND GREAT PLAINS**
10 **ENERGY?**

11 A. The relationship of the S&P business position ranking for each company to
12 its financial leverage and its S&P bond rating demonstrates that quantitative and
13 qualitative considerations of the type I have outlined are important in mitigating
14 the company's overall risk. The basic theory underlying S&P's business position
15 ranking is that companies with higher business risk must have correspondingly
16 lower financial risk to maintain any given level of overall risk. Given that DPL
17 Inc. and Great Plains Energy are ranked business position "6", in order to achieve
18 their "BBB" ratings these companies should have total debt to total capital no
19 greater than 53.5%, all other things being equal.¹ In fact, their leverage statistics
20 are higher than that, confirming that S&P considers other factors beyond financial

¹ Standard and Poor's, *Utilities & Perspectives*, June 21, 1999

1 leverage and business position in arriving at a composite risk assessment, and thus
2 a bond rating. Further, based solely on SCE&G's total debt to total capitalization
3 of 50% and a business position ranking of "4", S&P's published guidelines
4 indicate that the appropriate credit rating should be in the "BBB" range instead of
5 the "A-" rating which is currently outstanding for SCE&G. This is further
6 evidence that qualitative considerations play an important role in the derivation of
7 a composite risk assessment.

8
9 **Q. WHAT OTHER EVIDENCE DID YOU CONSIDER THAT LED YOU TO**
10 **BELIEVE THAT DPL INC. AND GREAT PLAINS ENERGY SHOULD BE**
11 **INCLUDED IN YOUR PEER GROUP?**

12 A. In the development and evaluation of a peer group, I sought to identify
13 companies whose business and financial risks, in the aggregate, are comparable to
14 SCE&G based on a variety of factors stated in my prefiled direct testimony.
15 These factors include relative size, asset concentration, regulatory environment,
16 and customer concentration & segmentation, among others.

17 I first sought to evaluate those companies of comparable size, based on my
18 knowledge and professional experience that a company's size affects its risk
19 profile and thus the rate of return expected by investors. Ibbotson Associates
20 provides seventy-five years of rate of return data for U.S equity securities which

1 supports the conclusion that investors require a higher return for their willingness
2 to commit capital to smaller companies. As Dr. Malkiel notes in his prefiled direct
3 testimony, Ibbotson's analysis shows that the rate of return for "... smaller
4 companies over the past 75 years has exceeded that of larger companies by
5 approximately 1.7 percentage points" (Malkiel Page 19 at Line 8-9). Based on
6 the data set forth in the table below and on my professional experience regarding
7 the ability of companies of this size to access the capital markets, I find DPL and
8 Great Plains to be of reasonably comparable risk to SCE&G.

Entity	Total Book Capitalization ^{1,2} (\$bn)
DPL	3.3
Great Plains Energy	2.0
SCE&G	3.5

SOURCE: SEC filings
NOTE:
1. As of 3/31/02
2. Defined as book value of equity plus long-term debt,
minority interest, capitalized leases, and preferred stock

9
10 Using asset concentration as a metric in determining comparability, I
11 evaluated each company based on its electric asset mix, its electric generation
12 portfolio and the contribution of its unregulated operations. As the table below
13 illustrates, DPL Inc., Great Plains Energy and SCE&G all have electric asset
14 portfolios that are weighted toward generation.

Entity	Net Book Value of Assets (\$mm) ¹						Total (\$)
	Generation (\$)	(%)	Transmission (\$)	(%)	Distribution (\$)	(%)	
DPL, Inc.	1,046	58%	222	12%	539	30%	1,807
Great Plains Energy Corp.	1,429	61%	136	6%	769	33%	2,334
SCE&G	1,459	53%	309	11%	1,003	36%	2,772

SOURCE: 2001 FERC Form 1, POWERDAT
NOTES:
1. As of 12/31/01

Further, the generation portfolios of DPL, Great Plains and SCE&G are all diversified by fuel source. As shown in the table below, each company relies on coal as its primary fuel source. Further, Great Plains and SCE&G are similarly invested in nuclear generation. For both Great Plains and SCE&G, nuclear generation capacity comprises approximately 15% of the total net electric generation capacity. In the case of SCE&G, Summer Station 1 is the largest electric generating unit and contributes approximately 13% to the total net electric generation capacity.² In the case of Great Plains, Wolf Creek 1 is the largest electric generating unit and contributes approximately 14% to the total net electric generating capacity.³ Overall, the electric asset mix and fuel diversification of DPL and Great Plains Energy are reasonably comparable to those of SCE&G.

Entity	Fuel Type (Net MW)																		Total
	Coal	%	Coal/Gas	%	Gas	%	Gas/Oil	%	Oil	%	Internal Combustion/ Diesel	%	Hydro	%	Nuclear	%	Other	%	
DPL Inc.	2,843	68.5%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	1308 ¹	31.5%	0	0.0%	0	0.0%	0	0.0%	4,151
Great Plains	2,235	59.9%	0	0.0%	488	13.1%	0	0.0%	460	12.3%	0	0.0%	0	0.0%	550	14.7%	0	0.0%	3,733
SCE&G	1,770	39.0%	922	20.3%	10	0.2%	349	7.7%	14	0.3%	0	0.0%	780	17.2%	635	14.0%	65	1.4%	4,544

SOURCE: 2001 10K
NOTES:
1. Classified as combustion turbines in Form 10K. Company has indicated that these units are gas-fired peakers.

² Source: POWERDAT

³ Source: POWERDAT

1 Both DPL Inc. and Great Plains Energy have unregulated operations in
2 addition to their regulated utility businesses. In the case of DPL, its regulated
3 businesses comprised approximately 66% of its consolidated operations as
4 reported in its SEC filings. However, I do not believe this figure to be an
5 appropriate measure of comparison in the case of DPL given that the company
6 holds a \$1 billion financial investment portfolio that the company has publicly
7 stated is comprised of liquid securities being held for the purpose of future energy
8 investments. Removing the effects of the financial portfolio on the consolidated
9 assets of the business would yield a regulated business that comprises
10 approximately 90% of DPL's consolidated operations.

11 Another area that I analyzed was the comparability of the regulatory
12 environments in which each of the peer companies and SCE&G operates. In my
13 judgment the regulatory environments in which DPL and SCE&G operate are
14 more similar than would first appear. Although Ohio has restructured its electric
15 industry, the state commission has taken a constructive approach to deregulation
16 and allowed DPL to retain the bulk of its generating facilities, thus mitigating the
17 commodity risk and purchase power recovery issue that has plagued certain
18 utilities operating in other deregulated environments. In the case of Great Plains
19 Energy, electric deregulation has not been enacted in either Kansas or Missouri,
20 whose regulatory commissions have been receptive to rate design and pricing
21 flexibility. Given the existence of relatively low electric rates in both Kansas and

Missouri and the low likelihood of future deregulation in those states, there are no outstanding issues as it relates to potential deregulation that would cause me to judge Great Plains as noncomparable to SCE&G.

Lastly, I focused on customer segmentation. DPL Inc., Great Plains and SCE&G all have significant concentrations of residential customers as part of their retail customer base. Residential customers traditionally have been a more stable source of income as their usage levels tend to be less sensitive to macroeconomic factors relative to those of commercial and/or industrial users. A table of electric customer segmentation is presented below for illustrative purposes:

Electric Customer Segmentation 2001										
Entity	Residential	%	Commercial	%	Industrial	%	Other Retail	%	Wholesale	% Total Customers
DPL Inc.	445,668	89	46,659	9	1,923	0	6,252	1	50	500,552
Great Plains Energy	417,536	88	52,596	11	2,365	1	116	0	50	472,663
SCE&G	462,162	85	75,432	14	1,005	0	3,400	1	34	542,033

SOURCE: FERC Form 1, POWERDAT

A table of total electric sales is presented below for illustrative purposes:

Total Electric Sales (MWh) 2001									
Entity	Residential	%	Commercial	%	Industrial	%	Other	%	Total
DPL, Inc.	4,909,198	27	3,617,892	20	4,568,165	25	4,959,568	27	18,054,823
Great Plains Energy	4,728,840	27	6,798,077	39	2,129,801	12	3,635,812	21	17,292,530
SCE&G	6,494,226	24	6,288,457	23	6,347,558	24	7,809,461	29	26,939,702

SOURCE: FERC Form 1, POWERDAT

In conclusion, based on the analysis of these areas of comparability along with the analysis previously presented in my prefled direct testimony and in my responses to various interrogatories related to the case, it is my professional opinion that it is reasonable to include both DPL Inc. and Great Plains Energy in the peer group.

1
2 **Q. GIVEN THE SIZE OF DPL’S FINANCIAL PORTFOLIO, DID YOU HAVE**
3 **ANY RESERVATIONS ABOUT INCLUDING IT IN YOUR PEER**
4 **GROUP?**

5 A. No. Despite its size, the company’s stated objectives as it relates to the
6 portfolio, the minimal internal resources dedicated to its management and the
7 diversification of the portfolio's assets all provide sufficient and reasonable
8 justification for including DPL Inc. in my peer group. DPL’s portfolio does not
9 violate the principle that the company be engaged primarily in regulated utility
10 operations. Such financial assets are, as the company declares in its latest
11 quarterly SEC filing “...an additional capital source, available to be invested in the
12 energy sector when that market has favorable investment conditions.”⁴ Moreover,
13 DPL’s objective “[has been] and continues to be first, asset preservation, and
14 second, earning an above market rate while seeking to mitigate risk through
15 diversification.”⁵

16 DPL’s portfolio is professionally managed and highly diversified. The
17 portfolio consumes minimal internal operational resources as it is managed by 27
18 experienced investment firms which, in turn, are currently investing in
19 approximately 500 companies operating in various industries in more than 30
20 countries.

⁴ DPL Inc. 9/30/02 10-Q, page 13

⁵ DPL Inc. 9/30/02 10-Q, page 15

1 According to the company, 19% of the portfolio (approximately \$200
2 million) is invested in publicly traded securities and can be liquidated immediately
3 if and as required. The remaining portion of the portfolio is comprised of passive
4 investments in private equity funds, which are saleable in an active secondary
5 market. Moreover, as of September 30, 2002, the size of DPL's financial asset
6 portfolio was approximately 48% of DPL's long-term debt, strengthening DPL's
7 credit profile by mitigating the risk of financial leverage and providing important
8 support for DPL's overall liquidity.

9 Income contribution for 2001, as defined by investment income divided by
10 the sum of operating income and investment income, from the portfolio is only 5%
11 and therefore, does not materially distort operating metrics or the focus that
12 management has placed on DPL's regulated utility business.

13
14 **Q. MR. GORMAN ALSO CITES A "\$155 MILLION WRITE-DOWN TO**
15 **REFLECT THE IMPAIRMENT TO THE VALUE OF [DPL'S]**
16 **INVESTMENT PORTFOLIO." PLEASE COMMENT ON THIS.**

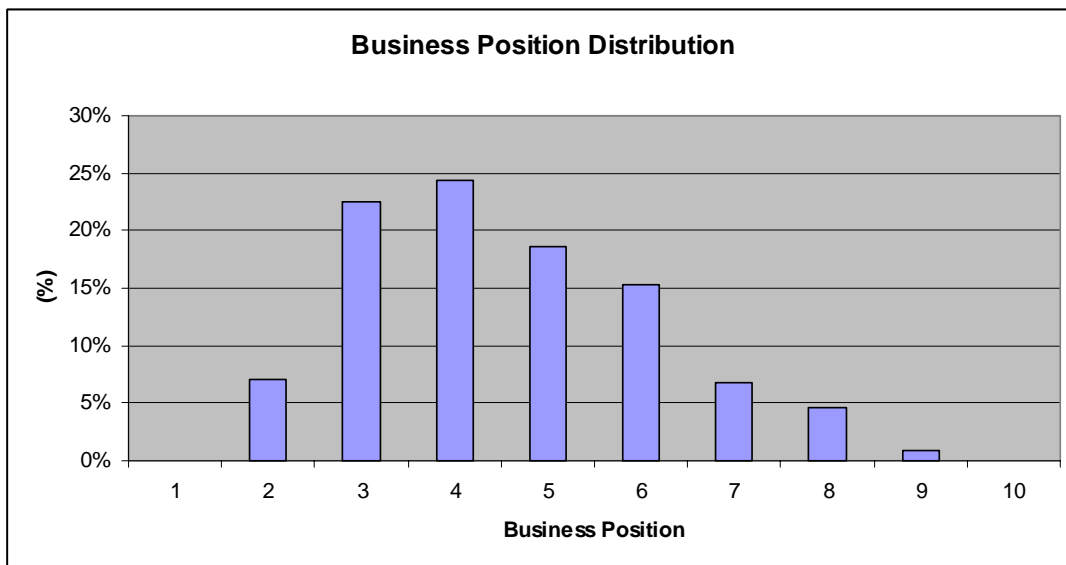
17 A. During the second quarter of 2002, DPL recorded a \$110 million after-tax
18 write-down to reflect a decline in the value of the portfolio's investments.
19 However, Mr. Gorman fails to note that the financial portfolio's net *gain* since
20 inception, as reported in DPL's 9/30/02 Form 10-Q, page 18, "stands at \$129

1 million as of September 30, 2002.” These gains are *after* giving effect to the
2 second quarter write-down.

3 In other words, the portfolio has not only met its primary stated investment
4 objective of asset preservation, since the value of the financial portfolio
5 substantially exceeds the company’s original investment, but also it has created
6 incremental value that can be invested in the company’s core energy businesses in
7 the future. Given the financial flexibility afforded DPL by its investment portfolio
8 and the other factors I have detailed, I believe the write-down is immaterial as it
9 relates to DPL's inclusion in my peer group.

10
11 **Q. DO YOU AGREE WITH MR. GORMAN’S STATEMENT THAT A**
12 **BUSINESS POSITION RANKING OF “6” IS “...OUT OF LINE WITH**
13 **INDUSTRY AVERAGES FOR UTILITY COMPANIES”?**

14 A. No. In fact, I believe that companies with an S&P business position
15 ranking of “4”, “5” or “6” are in line and well within the range of industry
16 averages. Based on S&P data published on a sample of 328 utility companies on
17 October 25, 2002, the average business position ranking is “4.6”, and in fact
18 approximately 60% of these companies fall within the “4”, “5” or “6” bandwidth.
19 The table below is illustrative of these empirical data.



The average business position rating for my peer group is also “4.6”, which indicates that my peer group’s business position is the *same* as that for the average of the 328 companies in the S&P universe. I would also note that the Comparable Group proposed by Mr. Gorman as Exhibit____(MPG-1), Schedule 2, carries an average business position of “4.7”, which is *higher* than the Osborne peer group, indicating, according to S&P's criteria and all other things being equal, *higher* average business risk in his comparable group than in mine.

Also, notwithstanding Mr. Gorman’s contention that a S&P business position rating of “6” is “out of line with SCE&G’s business position ... and is also out of line with industry averages for utility companies” (Gorman Page 17, at Line 13-15), he has included in his own Comparable Group a company whose business position rating is “6”, namely FPL Group. While I disagree with Mr. Gorman's inclusion of FPL Group as a comparable company for SCE&G, I do note that Mr. Gorman appears to agree with my finding that a business position

1 ranking of “6” is insufficient evidence for concluding that a company is not
2 comparable to SCE&G.

3
4 **Q. WHAT IS YOUR CONCLUSION ABOUT DPL INC. AND GREAT PLAINS**
5 **ENERGY AS COMPARABLE COMPANIES?**

6 A. I would note that there are no perfectly comparable companies and as stated
7 in my prefiled direct testimony “[T]here are very few publicly traded companies
8 that have the same business model and business risk profile as SCE&G” (Osborne
9 Page 10 at Line 15-16). It should be expected that even with the use of a peer
10 group, there may be some companies whose business and financial risks are
11 slightly higher or lower, although reasonably so, than those of the subject
12 company. Moreover, while it is not uncommon to encounter a metric that between
13 a peer and the subject company is non-comparable, the overriding objective is to
14 identify reasonably comparable companies with which to construct a peer group.
15 It is in this context that areas of non-comparability are offset, thus yielding a peer
16 group that, in aggregate, may serve as a proxy for the subject company.

17 In developing my peer group I sought to identify a group of companies
18 whose business and financial risks were, in the aggregate and on average,
19 comparable to those of SCE&G. While DPL Inc. and Great Plains Energy may
20 individually have moderately higher risks as they relate to business position and
21 financial leverage, they are in my judgment still within the range of comparability

1 to SCE&G based on the totality of various factors and metrics which I have
2 identified. Further, when included as part of a peer group containing companies
3 whose overall risks may be slightly lower than those of SCE&G, such as NSTAR
4 and Energy East, they result in a balanced set of comparable companies whose
5 business and financial risks in the aggregate and on average are a reasonable proxy
6 for those of SCE&G.

7
8 **Q. DO YOU AGREE THAT THE COMPANIES INCLUDED IN MR.**
9 **GORMAN'S COMPARABLE GROUP, AS SHOWN IN EXHIBIT**
10 **____(MPG-1), SCHEDULE 2 OF HIS DIRECT TESTIMONY, REPRESENT**
11 **A REASONABLE PROXY FOR EVALUATING SCE&G'S COST OF**
12 **EQUITY CAPITAL?**

13 A. No, I do not. While I agree that NSTAR and Pinnacle West Capital Corp.
14 should be included among a group of companies that form, in aggregate, a
15 reasonable proxy for evaluating SCE&G's cost of equity, I strongly disagree with
16 the inclusion of Ameren, Empire District Electric Co., FPL Group Inc. and
17 Southern Company.

18 As data from Ibbotson Associates clearly show and as stated in Dr.
19 Malkiel's prefiled direct testimony, "the rate of return for the stocks of smaller
20 companies over the past 75 years has exceeded that of larger companies" by a
21 substantial margin (Malkiel Page 19 at Line 7-8). To arrive at a reasonable proxy

1 thus requires that the peer companies be reasonably comparable in size. Four of
2 the companies in the Gorman peer group fail this test. Ibbotson defines large-cap
3 stocks as those whose market capitalizations exceed approximately \$5.2 billion.
4 For each of Ameren, FPL Group Inc. and Southern Company, equity market
5 capitalization exceeds \$7 billion, thus placing them above the upper range for mid-
6 cap companies that could be considered to be SCE&G's peers.

7 Further, as shown in the table below, the book capitalizations of Ameren,
8 FPL Group Inc. and Southern Company are substantially larger than that of
9 SCE&G. Also, the average size (as measured by book capitalization) of the
10 companies in the Gorman comparable group, at \$7,459 million, is much larger
11 than that of the Osborne peer group, at \$3,091 million, which is more closely
12 comparable to SCE&G, at \$3,541 million. To include companies of significantly
13 larger size could distort the cost of equity for SCE&G because significantly larger
14 companies are expected to have a lower required cost of equity than SCE&G, as
15 demonstrated by Dr. Malkiel's analysis of the estimated cost of capital for large
16 capitalization utilities (Malkiel Page 18-20).

17 Conversely, Empire District Electric Co. should be excluded because its
18 size is less than one-fifth that of SCE&G. To include a company of such
19 significantly smaller size could likewise distort the required cost of equity.

For the foregoing reasons, I believe that the Gorman comparable group, in aggregate, fails to represent a reasonable proxy for evaluating SCE&G's cost of equity.

Entity	Book Capitalization^{1,2} (\$mm)
SCE&G	3,541.0
DPL Inc	3,300.3
Energy East Corp.	4,567.3
Great Plains Energy Inc.	1,948.1
IDACORP Inc.	1,595.9
NSTAR	2,522.1
Pinnacle West Capital Corp.	5,814.1
Vectren Energy	1,888.8
Mean	3,090.9
Ameren Corp.	7,016.0
Empire District Electric Co.	625.4
FPL Group Inc.	11,372.0
NSTAR	2,522.1
Pinnacle West Capital Corp.	5,814.1
Southern Co.	17,405.7
Mean	7,459.2

SOURCE: SEC filings

NOTE:

1. As of 3/31/02

2. Book Capitalization is defined as book value of equity plus long-term debt, minority interest, capital leases, and preferred stock

Q. DO YOU AGREE THAT THE COMPANIES INCLUDED IN MR. PARCELL'S COMPARABLE GROUP, AS SHOWN IN EXHIBIT ____ (DCP-1), SCHEDULE 8, PAGE 4 OF 4, OF HIS DIRECT TESTIMONY, REPRESENT A REASONABLE PROXY FOR EVALUATING SCE&G'S COST OF EQUITY CAPITAL?

1 A. No, I do not. While I agree that Energy East, Great Plains Energy and
2 Pinnacle West Capital Corp. should be included among a group of companies that
3 form, in aggregate, a reasonable proxy for evaluating SCE&G's cost of equity, I
4 disagree with Mr. Parcell's inclusion of OGE Energy and Pepco Holdings. This is
5 because these two companies face substantially different risks from SCE&G.

6
7 **Q. PLEASE DESCRIBE WHY YOU BELIEVE THAT OGE ENERGY**
8 **SHOULD BE EXCLUDED FROM MR. PARCELL'S COMPARISON**
9 **GROUP?**

10 A. OGE Energy falls within the range of comparability with respect to size,
11 leverage, bond ratings and S&P business position ranking, but its non-utility
12 business investment is higher than that of any of the other peers I selected for
13 SCE&G, at approximately 39% of total assets. Moreover, the business mix within
14 OGE Energy's non-utility segment further reduces its comparability. This
15 segment includes investments in intrastate and interstate gas pipelines, gas storage,
16 gas gathering systems, gas processing, energy marketing and trading, and, until
17 recently, energy exploration and production. In 1999, the company acquired Tejas
18 Transok Holdings for \$725 million, which transformed OGE Energy into one of
19 the largest gas processors in the state of Oklahoma. This is a highly volatile
20 business, as has been demonstrated by that segment's operating results since the
21 acquisition. During 2001, for example, the company's non-utility businesses saw

1 a 50% drop in EBIT due in large part to adverse price conditions in the volatile
2 natural gas liquids markets. On page 16 of its 2001 Form 10-K, OGE Energy
3 states that it expects its non-utility business “to improve its operational
4 performance by reducing the volatility related to natural gas processing. [OGE
5 Energy] continually monitors the market instruments available to hedge the
6 fractionation spread, however, at this time there are no products available that in
7 management’s opinion satisfactorily accomplish this objective.” Based on the size
8 of OGE Energy's investment in non-utility businesses, the significant internal
9 operational resources dedicated to the active management of these businesses and
10 on their concentrated exposure to energy commodity price risk, I believe OGE
11 Energy is not a fair proxy for the risks faced by SCE&G and, thus should be
12 excluded from the peer group.

13
14 **Q. PLEASE DESCRIBE WHY YOU BELIEVE THAT PEPCO HOLDINGS**
15 **SHOULD BE EXCLUDED FROM MR. PARCELL’S COMPARISON**
16 **GROUP?**

17 A. Based on my knowledge of the industry and experience as it relates to
18 mergers and acquisitions within the power sector, it is my opinion that Pepco
19 Holdings is not a reasonably comparable company for SCE&G due to the
20 circumstances surrounding its recent acquisition of Conectiv, as well as the nature
21 of Conectiv’s unregulated operations.

1 Pepco's acquisition of Conectiv can best be described as an opportunistic
2 purchase of a relatively weakened company. Prior to the acquisition, Conectiv
3 was weakened primarily as a result of its failure to effectively cope with the
4 deregulating energy markets and losses at its telecommunications unit. These
5 events eventually culminated in Pepco's offering to acquire Conectiv on February
6 12, 2001. On August 1, 2002 Pepco's acquisition of Conectiv closed. From that
7 date forward, Pepco has been exposed to significant integration risk as it attempts
8 to consolidate Conectiv's operations into those of its own. This integration risk
9 arises, in part, from the pairing of the operations of Pepco to those of Conectiv,
10 whose contribution from unregulated operations is relatively high. In fact, for
11 Pepco, approximately 75% of its 2001 consolidated assets were derived from its
12 regulated utility operations. By comparison, only about 60% of Conectiv's 2001
13 investments in plant, property and equipment came from its regulated operations,
14 with the balance being derived from its unregulated operations, in part, made up of
15 merchant generation, trading and marketing.

16 Business risk is compounded given that, unlike the management of
17 companies such as Energy East that have a proven track record of successfully
18 executing and integrating significant acquisitions, Pepco's management is
19 relatively untested in this arena. Further compounding the business risks
20 associated with the acquisition is the fact that the addition of Conectiv's
21 unregulated portfolio materially changes the overall business risk of the company.

1 It is, in my judgment, reasonable to state that Pepco currently faces business risks,
2 and more specifically operational and management risk, that are materially
3 different from those of SCE&G.

4 Thus, the combination of the recent merger, integration risk, and an
5 increased investment in unregulated businesses, has resulted in a merged company
6 whose current risk profile differs materially from that of SCE&G. For that reason,
7 Pepco Holdings should be excluded.

8
9 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.**

10 A. For the reasons stated above, it is my conclusion that the groups of
11 companies selected by witnesses Parcell and Gorman are not in fact reasonably
12 comparable to SCE&G in the aggregate. Therefore, any analyses performed using
13 either witness Parcell's or witness Gorman's proposed group of comparable
14 companies would not accurately reflect SCE&G's required rate of return. Further,
15 I believe the group of companies set forth in my direct testimony is the most
16 reasonable group of comparable companies to use in determining SCE&G's cost
17 of equity capital.

18
19 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

20 A. Yes.